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# INDEX

|  | Page |
|--|------|
| Opinions below.....  | 1    |
| Jurisdiction.....  | 1    |
| Question presented.....  | 2    |
| Statute involved.....  | 2    |
| Statement.....   | 2    |
| Specification of errors to be urged.....   | 3    |
| Summary of argument.....   | 4    |
| Argument:  |      |
| The owner of the bonds continued to be taxable under<br>Section 22 (a) with respect to the interest coupons which<br>he gave to his son..... | 6    |
| Conclusion.....  | 13   |

## CITATIONS

### Cases:

|   |                       |
|---|-----------------------|
| <i>Balkwill v. Commissioner</i> , 77 F. (2d) 569, certiorari denied,<br>296 U. S. 609.....    | 10                    |
| <i>Bing v. Bowers</i> , 22 F. (2d) 450, affirmed, 26 F. (2d) 1017.....                        | 12                    |
| <i>Blair v. Commissioner</i> , 300 U. S. 5.....   | 11                    |
| <i>Burnet v. Leininger</i> , 285 U. S. 136.....   | 5, 19, 11             |
| <i>Dickey v. Burnet</i> , 56 F. (2d) 917, certiorari denied, 287 U. S.<br>606.....            | 12                    |
| <i>Douglas v. Willcuts</i> , 296 U. S. 1.....   | 13                    |
| <i>Griffiths v. Commissioner</i> , 308 U. S. 355.....   | 9, 11                 |
| <i>Helvering v. Bruun</i> , 309 U. S. 461.....  | 13                    |
| <i>Helvering v. Clifford</i> , 309 U. S. 331.....   | 4, 5, 6, 7, 8, 12, 13 |
| <i>Helvering v. Gordon</i> , 87 F. (2d) 663.....  | 12                    |
| <i>Helvering v. Midland Ins. Co.</i> , 300 U. S. 216.....                                     | 13                    |
| <i>Helvering v. Stockholms &amp; Bank</i> , 293 U. S. 84.....                                 | 13                    |
| <i>Higgins v. Smith</i> , 308 U. S. 473.....  | 9                     |
| <i>Irwin v. Gavit</i> , 268 U. S. 161.....  | 13                    |
| <i>Kasch v. Commissioner</i> , 63 F. (2d) 466.....  | 10                    |
| <i>Lucas v. Earl</i> , 281 U. S. 111.....   | 5, 9, 11              |
| <i>Matchette v. Helvering</i> , 81 F. (2d) 73, certiorari denied, 298<br>U. S. 677.....       | 12                    |
| <i>Porter v. United States</i> , 52 F. (2d) 1056.....   | 12                    |
| <i>Reinecke v. Smith</i> , 289 U. S. 172.....   | 5, 9, 11              |
| <i>Rosenwald v. Commissioner</i> , 33 F. (2d) 423, certiorari de-<br>nied, 280 U. S. 599..... | 12                    |
| <i>Rossmoore v. Commissioner</i> , 76 F. (2d) 520.....  | 10                    |

## II

### Cases—Continued.

|  | Page |
|--|------|
| <i>Saenger v. Commissioner</i> , 69 F. (2d) 631.....   | 12   |
| <i>United States v. Safety Car Heating Co.</i> , 297 U. S. 88.....                           | 13   |
| <i>Ward v. Commissioner</i> , 58 F. (2d) 757, certiorari denied,<br>287 U. S. 656.....       | 12   |
| <i>Wood v. Commissioner</i> , 74 F. (2d) 78.....   | 12   |
| <b>Statute:</b>  |      |
| Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 22 (a) (U. S.<br>C., Title 26, Sec. 22)..... | 2    |

# **In the Supreme Court of the United States**

**OCTOBER TERM, 1940**

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**No. 27**

**GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, PETITIONER**

**v.**

**PAUL R. G. HORST**

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**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT  
COURT OF APPEALS FOR THE SECOND CIRCUIT**

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**BRIEF FOR THE PETITIONER**

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## **OPINIONS BELOW**

The opinion of the United States Board of Tax Appeals (R. 14-19) is reported in 39 B. T. A. 757. The opinion of the Circuit Court of Appeals (R. 26-28) is reported in 107 F. (2d) 906.

## **JURISDICTION**

The judgment of the Circuit Court of Appeals was entered December 2, 1939 (R. 28). The petition for a writ of certiorari was filed March 2, 1940, and granted April 8, 1940 (R. 29). The jurisdiction of this Court rests on Section 240 (a)

of the Judicial Code, as amended by the Act of February 13, 1925.

#### QUESTION PRESENTED

The taxpayer owned coupon bonds. Several months prior to maturity of the interest coupons he detached them and gave them to his son, retaining the bonds themselves. Is he relieved of income tax with respect to such interest coupons?

#### STATUTE INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

##### SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived \* \* \* from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \* [U. S. C., Title 26, Sec. 22.]

#### STATEMENT

The facts, as stipulated (R. 22-24) and as found by the Board of Tax Appeals (R. 15), may be stated as follows:

The taxpayer, during the years 1934 and 1935, kept his books and made his income-tax returns on the cash receipts and disbursements basis (R. 15).

Throughout the year 1934 taxpayer owned certain coupon bonds. On August 10, 1934, he detached, prior to their maturity, negotiable interest coupons in the face amount of \$25,182.50, and trans-

ferred them by manual delivery to his son, Robert P. K. Horst, as a gift. All of the coupons matured during the year 1934, and in that year the son collected the total amount due and reported it in his income-tax return for that year. (R. 15.)

Similarly, in August, 1935, he again detached interest coupons and gave them to his son, who collected \$25,495 during that year on account of the coupons, and who reported that amount in his return ~~\$22,360~~<sup>1</sup> for 1935. (R. 15.)

The taxpayer did not report in his income tax returns for the years 1934 and 1935 any part of the amounts represented by the foregoing interest coupons. The Commissioner of Internal Revenue determined deficiencies for the years in question by adding \$25,182.50 to gross income for 1934 and \$22,360<sup>1</sup> for 1935 (R. 15).

The Board of Tax Appeals upheld the Commissioner's determination, with three members dissenting. The Circuit Court of Appeals reversed.

#### **SPECIFICATION OF ERRORS TO BE URGED**

The Circuit Court of Appeals erred:

1. In holding that the owner of bonds need not include in his gross income an amount on account of the interest coupons which he detached and gave to his son several months prior to maturity.

2. In failing to hold that the owner of bonds should include the proceeds of the interest coupons

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<sup>1</sup> He should have added \$25,495 for 1935. The lower amount was undoubtedly an error.

in his gross income although he detached and gave them to his son several months prior to maturity.

3. In reversing the decision of the Board of Tax Appeals.

#### SUMMARY OF ARGUMENT

1. The owner of the bonds remained liable for income tax with respect to the interest thereon under the principles of *Helvering v. Clifford*, 309 U. S. 331. There, a taxpayer who had declared himself trustee of securities for five years to pay the income to his wife, reserving broad powers of management over the corpus, was held liable for tax with respect to the income which he had thus irrevocably set apart for his wife. The Court regarded as the "basic issue" whether or not "the grantor after the trust has been established may still be treated, under this statutory scheme, as the owner of the corpus." And the Court concluded that in view of the short duration of the trust, the retention of control over the corpus and the relationship between grantor and beneficiary, the husband should be treated as the owner of the corpus liable for tax upon the income therefrom.

The present case follows *a fortiori*. Here there was not even the interposition of a trust. The taxpayer continued to own the corpus outright, retaining all the powers of control which accompany ownership. Moreover, the short period of time between the gift of the interest coupons and their maturity more than matches the five year period in the *Clifford case*. And finally, the existence of a

close family relationship between grantor and beneficiary in the *Clifford* case is likewise present here.

The fact that the interest herein was embodied in separately disposable coupons should not make any difference. The beneficiary in the *Clifford* case similarly had an indefeasible right to income which she could readily assign. The transferability of the coupons by manual delivery may perhaps render assignability more dramatic in the present case, but the essential fact is that in both cases there was a complete alienation of the income by the taxpayer; and the considerations which required the taxpayer to remain accountable with respect to such income are all present here.

2. Moreover, the taxpayer is liable under the general rule that an assignor of income may not relieve himself of tax where he continues to own the underlying property that produces the income. This Court has held that the assignor of income from personal services remains liable for tax thereon. *Lucas v. Earl*, 281 U. S. 111. And in *Burnet v. Leininger*, 285 U. S. 136, the rule was extended to partnership income that was the product of *both* personal services and capital investment. Those two decisions have been cited by this Court as authority for the statement that "an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income" (*Reinecke v. Smith*, 289 U. S. 172, 177).

## ARGUMENT

THE OWNER OF THE BONDS CONTINUED TO BE TAXABLE UNDER SECTION 22 (A) WITH RESPECT TO THE INTEREST COUPONS WHICH HE GAVE TO HIS SON

1. That the owner of the bonds could not relieve himself of tax with respect to the interest thereon simply by giving the coupons away shortly before their due date is clear, we submit, in the light of *Helvering v. Clifford*, 309 U. S. 331. There a husband declared himself trustee of certain securities to pay the income therefrom to his wife for five years. The trust was irrevocable, but the grantor retained broad powers of management. At termination, the corpus was to revert to him, while all accrued income was to go to his wife. He paid a gift tax upon the creation of the trust, and his wife reported in her separate returns all of the trust income distributed to her. This Court nevertheless held that the husband was taxable with respect to such income under Section 22 (a), notwithstanding that it had been distributed to another who was legally entitled to it. The Court regarded as the "basic issue" whether or not "the grantor after the trust has been established may still be treated, under this statutory scheme, as the owner of the corpus" (p. 334). And in holding the grantor taxable, the Court thus summarized the considerations which brought about that result (p. 335):

the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion

that respondent continued to be the owner for purposes of § 22 (a).

The result in the instant case should follow *a fortiori* from the *Clifford* decision. Here there was not even the interposition of a trust. The father continued to own and control the corpus outright, without the necessity of going through the ritual of reserving broad powers of management as was done in the *Clifford* case. Again, the "short duration" of the trust, commented upon in the *Clifford* decision, is more than matched in this case. As against the five-year period in the *Clifford* case, there was here but a spread of several months between the gift of the interest and its due date. And finally, the close family relationship between grantor and beneficiary in the *Clifford* case finds its counterpart here in the fact that the object of the taxpayer's generosity was his son.

We respectfully submit that the instant case presents a far stronger case for the imposition of the tax. The taxpayer retained not merely broad powers over the corpus that might be translated into the substantial equivalent of ownership. He retained full ownership itself of the corpus, thereby resolving at the very outset the "basic issue" as it was posed in the *Clifford* decision.

There is, it is true, a single factual difference which the court below stressed in holding the tax invalid:<sup>2</sup> namely, that the income was embodied in

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<sup>2</sup> The decision below was rendered prior to this Court's decision in the *Clifford* case.

negotiable coupons that were susceptible of separate ownership and control in the hands of the donee. We respectfully submit, however, that this difference is a purely formal one. The beneficiary in the *Clifford* case similarly had an indefeasible right to the income, a right which she could presumably assign, just as readily as the donee of the interest coupons could dispose of the latter by manual delivery. True, it may be more convenient to reassign the interest by the simple process of delivering the coupons, and it may perhaps be easier to find an assignee in view of the negotiable feature of the coupons, but these considerations do not detract from the single dominant fact which ties the cases together: there was just as complete and final alienation of the income in question in the *Clifford* case as there was here. The fact that the income here was identified with the separately disposable coupons may have rendered that alienation more dramatic, but it cannot obscure the common ground between the two cases. In both cases the owner of property about to receive income therefrom in the near future attempted to shift the incidence of the tax by deflecting the income to a member of his family without at the same time relinquishing his control over the property itself. It is difficult to believe that a different result should obtain by reason of a purely formal difference, particularly since all the other considerations in this case point even more strongly towards taxability.

In substance, the taxpayer simply made a gift of income to his son. Had he collected the interest

payments themselves and then paid over the proceeds to his son, or indeed, had he directed his son to collect the proceeds as his agent and to keep them as a gift, he would have remained liable.\* Such technical variations upon the transaction which do not alter its practical substance should not produce diversity of tax consequences. Cf. *Griffiths v. Commissioner*, 308 U. S. 355; *Higgins v. Smith*, 308 U. S. 473.

2. In any event, since the gift of the coupons was simply an assignment of income, the donor is taxable under the general rule that an assignor of income cannot relieve himself of tax where he continues to own the underlying property that produces the income. The rule was plainly and unambiguously set forth by the Court in *Reinecke v. Smith*, 289 U. S. 172, where it stated (p. 177):

This court has repeatedly said that such an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income. \* \* \*

The Court then adverted to *Burnet v. Leininger*, 285 U. S. 136, and *Lucas v. Earl*, 281 U. S. 111.

*Lucas v. Earl* dealt with an assignment of income from personal services rather than income from

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\* Indeed, under ordinary standards, the respondent made a gift to his son which was largely past rather than future income. The coupons were given one to four months in advance of maturity (R. 10). Although respondent kept his books upon a cash basis, the commercial truth of the matter is that the accrued interest was already his; he could have discounted the coupon, or had he sold the bond, his receipts would have reflected the accrued interest.

property. The assignment had been made nearly *twenty* years before the tax years in question. In holding the assignor taxable the Court declared (p. 114) that the case is "not to be decided by attenuated subtleties", and it refused to sanction an anticipatory arrangement (p. 115) "by which the fruits are attributed to a different tree from that on which they grew".

That the rule of *Lucas v. Earl* was not limited to assignments of income from personal services alone soon became apparent in *Burnet v. Leininger*, *supra*. In the *Leininger* case, the taxpayer, a partner in a laundry business, assigned "one-half of his interest to his wife, and thus attempted to avoid tax on one-half of his distributive income from the business. This Court held, however, that he nevertheless continued to remain taxable on the full amount of his distributive share."<sup>5</sup> But the income in the *Leininger* case arose from more than mere personal services. It was partnership income, a portion of which was undoubtedly *attributable to capital investment*. Although the personal efforts of the partner may have contributed towards the

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<sup>4</sup> Literally, the taxpayer attempted to make his wife an "equal partner" with him in his interest in the company. The Court, however, treated the situation simply as "an equitable assignment of one-half of what her husband should receive from the partnership". 285 U. S. at 141.

<sup>5</sup> See also *Balkwill v. Commissioner*, 77 F. (2d) 569 (C. C. A. 6th), certiorari denied, 296 U. S. 609; *Kasch v. Commissioner*, 63 F. (2d) 466 (C. C. A. 5th); *Rossmore v. Commissioner*, 76 F. (2d) 520 (C. C. A. 2d).

production of that income, it flowed, in part at least, from property. The Court, however, drew no distinction between the two possible sources of income, but rather held broadly that the assignor remained liable. The Court in *Reinecke v. Smith*, *supra*, was therefore entirely justified in invoking the *Leininger* decision to support its statement that "an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income." Moreover, it is clear from a recent decision of this Court that neither the decision nor the language of the opinion in *Lucas v. Earl* is to be restricted to income from personal services. See *Griffiths v. Commissioner*, 308 U. S. 355, 358.

In holding that the taxpayer had succeeded in freeing himself of liability the court below relied upon *Blair v. Commissioner*, 300 U. S. 5. But that decision simply brings into striking relief the rule for which we are contending. There the assignor did not continue to own the property that gave rise to the income received by the assignee. The assignor originally owned an equitable life estate in property held in trust entitling him to all the net income derived from the property and then irrevocably parted with his entire interest in the property that produced the income received by the assignee. Here, on the other hand, the assignor continued to own the property which gave rise to the income in question—a distinction which is pivotal

if the foregoing decisions of this Court and their reasoning be accepted.\*

3. The application of the principles established either by the *Clifford* case or by the assignment of income cases is particularly called for in view of the broad and comprehensive language of the statute. Section 22 (a) in all-inclusive terms defines gross income as including—

\* With minor exceptions the lower courts have repeatedly held that a taxpayer who assigns income from property while at the same time retaining the underlying property which produces that income does not relieve himself of tax with respect to that income. E. g., *Bing v. Bowers*, 22 F. (2d) 450, 454 (S. D. N. Y.), affirmed, 26 F. (2d) 1017 (C. C. A. 2d); *Porter v. United States*, 52 F. (2d) 1056 (C. Cls.); *Ward v. Commissioner*, 58 F. (2d) 757 (C. C. A. 9th), certiorari denied, 287 U. S. 656; *Wood v. Commissioner*, 74 F. (2d) 78 (C. C. A. 6th); *Helvering v. Gordon*, 87 F. (2d) 663 (C. C. A. 8th). See *Saenger v. Commissioner*, 69 F. (2d) 631, 632 (C. C. A. 5th). Cf. *Dickey v. Burnet*, 56 F. (2d) 917, 921 (C. C. A. 8th), certiorari denied, 287 U. S. 606.

In *Rosenwald v. Commissioner*, 83 F. (2d) 423 (C. C. A. 7th), certiorari denied, 280 U. S. 599, the taxpayer assigned about \$830,000 income from rents, stocks and bonds. The court held about \$815,000 thereof taxable to him, but relieved him of tax as to the remainder which represented bond coupons similar to those involved herein. Since the Government had prevailed as to the great bulk of the contested income, it did not apply for certiorari with respect to the relatively small amount attributable to the coupons. However, we believe that the distinction which the court drew between the assignment of income generally from property and the assignment of income represented by interest coupons is unsound. See discussion *supra*, p. 8. Cf. *Matchette v. Helvering*, 81 F. (2d) 73 (C. C. A. 2d), certiorari denied, 298 U. S. 677.

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gains, profits, and income \* \* \* growing out of the ownership or use of or interest in such property [or derived] from interest, rent, dividends, securities \* \* \* or gains or profits and income derived from any source whatever.

and this Court has often said that the sweeping language of those provisions indicates that it was the purpose of Congress to use its power to the full extent. *Douglas v. Willcuts*, 296 U. S. 1, 9; *Irwin Gavit*, 268 U. S. 161; *Helvering v. Stockholms Bank*, 293 U. S. 84, 89; *United States v. Safety Heating Co.*, 297 U. S. 88, 93; *Helvering v. Highland Ins. Co.*, 300 U. S. 216, 223; *Helvering v. Ford*, 309 U. S. 331, 334. Cf. *Helvering v. Egan*, 309 U. S. 461, 468.

#### CONCLUSION

The judgment of the court below should be reversed and that of the Board of Tax Appeals affirmed.

Respectfully submitted.

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OCTOBER, 1940.